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No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General,
et al.,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLANTS' REPLY BRIEF

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APPELLANTS' REPLY BRIEF[1]

Introduction

No amount of rhetoric or obfuscation can alter the one fact that controls this case. As the North Carolina Supreme Court stated, the NCUC here set retail electric rates in North Carolina by itself "allocat[ing]" wholesale costs of producing and distributing electricity "between the public load customers in North Carolina and the industrial load customer (Alcoa) in Tennessee." Appendix to Jurisdictional Statement ("App") 16a. The NCUC excluded from Nantahala's North Carolina retail rates some $45 million in wholesale costs that were "associated with" and "actually incurred" by Nantahala as a result of the pertinent FERC rate schedule, and the NCUC "effectively allocated [these costs] for rate making purposes to the systems' industrial customer, Alcoa, on whose behalf the [NCUC] determined they were

[1]The Statement of Appellants Required by Rule 28.1 appears at p. ii of the Jurisdictional Statement.

incurred." App. 69a-70a. This is precisely what the Federal Power Act and the Commerce Clause forbid. States have no jurisdiction to make these interstate wholesale cost allocations, but must include the precise wholesale costs that result from the pertinent FERC rate schedules (or FERC decisions modifying them) in the local utility's retail revenue requirements and retail rates.

The most striking feature of the briefs of appellees and the two *amici* who support them is that none disputes this central point. No one disputes that Congress enacted the Federal Power Act to confer exclusive jurisdiction over interstate wholesale cost allocations on FERC, as a neutral federal agency. Appellants' Br. pp. 21-22. No one disputes that Congress, like this Court before it, recognized that it would profoundly burden interstate commerce if each interested State could make its own separate determination of how interstate wholesale costs of producing electricity should be divided among customers in different States. *Id.* pp. 30-31. No one disputes that this would lead to the incessant litigation that Congress sought to prevent (*id.* pp. 31-32), and that each affected State would also seek to adopt allocations that would advance its selfish interests at the expense of neighboring States. *Id.* p. 30. It is this kind of parochialism that led to a constitutional convention 200 years ago.

Nonetheless, these three North Carolina entities offer a series of arguments in defense of what North Carolina has done. None has any substance.

I. North Carolina's Actions Are Preempted By The Federal Power Act.

A. There Are No "Unique Facts" That Could Permit Departure From Established Principles.

Initially, appellees "fully accept" (p. 15) the principle that any state action which interferes, directly or indirectly, with FERC's exclusive jurisdiction to determine the proper interstate allocations of wholesale costs is preempted.[2] Specifically, they acknowledge that this Court's "filed-rate doctrine" protects FERC's exclusive jurisdiction over bulk power supply arrangements[3] and that state supreme courts and now federal courts have uniformly implemented this doctrine in *Narragansett*,[4] *Northern States*,[5] and other decisions.[6] While recognizing the broad latitude that States enjoy in determining the other components of retail revenue requirements and retail rates,[7] this doctrine requires States, in setting retail rates, to do what the NCUC refused to do here: include the power acquisition costs that result from the pertinent FERC rate schedule in retail revenue requirements and retail rates. If a State believes that the FERC rate schedule is unfair to its residents, the state commission's exclusive remedy is to seek modification of the rate schedule in a properly instituted FERC proceeding (and make provisions in the retail rate order for a refund to the extent such modifications are thereafter ordered by FERC). *Narragansett*, *supra*, 381 A.2d at 1363; *Northern*

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[2] *Maryland* v. *Louisiana*, 451 U.S. 725, 749-50 (1981); see *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, 54 U.S.L.W. 4114 (Jan. 22, 1986).

[3] *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951).

[4] *Narrangansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

[5] *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981).

[6] See Appellants' Br. 25-29. Since appellants' brief was filed, lower federal courts have acknowledged this *Narragansett-Northern States* doctrine in *New Orleans Public Service, Inc.* v. *New Orleans*, 782 F.2d 1236, 1241-42 (5th Cir. 1986); *Appalachian Power Co.* v. *Public Service Commission of West Virginia*, No. 2: 85-0098 (S.D. W.Va. Feb. 14, 1986), and *Arkansas Power & Light Co.* v. *Missouri Public Service Commission*, No. 86-4067-CV-C-5 (W.D. Mo. March 10, 1986).

[7] For example, state commissions determine the value of the retail rate base, set the allowed rate of return, and determine whether expenses outside FERC's jurisdiction should be included in retail revenue requirements.

States, *supra*, 314 N.W. 2d at 38. FERC, and FERC alone, can authorize departures from the bulk power supply arrangements filed by the utility and their associated costs. When FERC does so—as it did here[8]—this establishes a new filed rate that equally binds the States.

While accepting this principle, the North Carolina entities made three separate arguments that it is inapplicable here due to the "unique facts" of this case.

Alcoa's Alleged Domination. Appellees' primary claim, made in arguments scattered throughout their brief (*e.g.*, pp. 10, 13–14, 17, 27 & n. 27, 36), is that FERC should not have exclusive jurisdiction over cost allocation questions here because of the appellees' *allegation* that Alcoa, as the sole shareholder of Nantahala and Tapoco, dominated these utilities. Specifically, they claim (*e.g.*, p. 17) that Alcoa is guilty of self dealing, that it generally preferred its interests over those of the North Carolina public load over a 40 year period, and that those preferences are reflected in the NFA and the 1971 Apportionment Agreement that comprise Nantahala FERC Rate Schedule No. 1.

But this allegation cannot deprive FERC of jurisdiction. To the contrary, as the Fourth Circuit held when it rejected this very domination argument in the parallel federal proceedings,[9] these

[8]Appellees are simply incorrect in arguing (p. 17) that FERC is "no less bound" by the filed-rate doctrine "than is a state commission" and that the fact that FERC can modify utility-filed rate schedules means that States can ignore them altogether in setting retail rates. The statutory scheme requires FERC to investigate a utility's contractual bulk power supply arrangements and reject those that are unreasonable. This is the exercise of the regulatory function that Congress assigned FERC and FERC alone. In contrast, it would nullify the congressional plan if a State could simply refuse to give effect to a FERC rate schedule (or decision modifying it) in setting retail rates.

[9]The Fourth Circuit held that the conflict between the interests of Nantahala's shareholder (Alcoa) and its customers is no different in kind than that present in any case FERC decides. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1347–48 (4th Cir. 1984). The Court

(Footnote continued on following page)

are precisely the kind of claims that must be decided by an impartial federal tribunal rather than a self-interested State when, as here, interstate wholesale cost allocations are involved. This is vividly demonstrated by the fact that the North Carolina Attorney General (on behalf of Nantahala's retail customers) here vigorously litigated its domination claims before FERC in the earlier complaint proceeding under Section 206 of the Federal Power Act. There, FERC flatly rejected this claim and agreed with the earlier conclusions of even the NCUC that the challenged arrangements are fair to Nantahala's retail customers.[10] Moreover, contrary to appellees' assertions that no court has disagreed with their position (p. 2), FERC's findings were affirmed,

(Footnote continued from previous page)

further held that FERC can, and did, "scrutinize . . . the fairness of all transactions allocating resources between Tapoco and Nantahala" to assure that "Alcoa's needs" and the "different, and often conflicting, needs of Nantahala" were reasonably accommodated. *Id.* at 1348.

[10]Prior to the order on review, the NCUC found that the NFA and 1971 Apportionment Agreements were fair and reasonable to Nantahala ratepayers on at least two separate occasions. See *North Carolina ex rel. Utils. Commn* v. *Edmisten*, 291 N.C. 575, 232 S.E.2d 177, 179 (1977) (describing NCUC finding); *North Carolina ex rel. Utils. Commn* v. *Edmisten*, 299 N.C. 432, 263 S.E.2d 583 (1980) (same); Tr. Vol. 6, pp. 25–27. It is presumably for this reason that the NCUC did not itself initially challenge these agreements in the FERC proceedings under Sections 205 and 206 of the Federal Power Act.

In this regard, appellees' repeated allegations of a "long history of domination" and improper conduct by Alcoa from the 1930s to 1960s are ironic. There is abundant evidence that Alcoa's development of hydroelectric facilities in North Carolina conferred enormous benefits on Nantahala ratepayers (Tr. Vol. 7, pp. 38–39; Ex. JML-4), and these are facts which even the North Carolina Court of Appeals unanimously accepted in this case:

> "[A] good argument could be made that the best friend Nantahala's customers have is Alcoa. It financed the building of large hydroelectric facilities at a time when Nantahala could not have justified constructing them for its public customers. Nantahala's customers have had for many years the benefit of these facilities built at 1941 costs."

(Footnote continued on following page)

and appellees' arguments rejected, by the Fourth Circuit. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1346–49 (4th Cir. 1984).

In short, appellees' factual claims were presented to FERC, and to the Fourth Circuit. And they lost. They lost before FERC and they lost before the Fourth Circuit—both of which are neutral tribunals with no interest in favoring one State over another in allocating low-cost power. To permit North Carolina or any other State to relitigate these matters, disregard FERC's findings, and thereby appropriate more low-cost hydroelectric power than allocated by FERC would thoroughly subvert the uniform, orderly, and evenhanded scheme that Congress established.[11]

(Footnote continued from previous page)
App. 164a. Thus, Nantahala's retail rates (as filed with the NCUC) have been found to be the lowest in North Carolina, and they are among the lowest in the nation. See United States Department of Energy, Energy Information Administration, *Typical Electric Bills: January 1, 1985*, pp. 17, 125 (1985); Tr. Vol. 14, p. 63; Tr. Vol. 9, p. 12.

[11]This is especially so because Nantahala's retail customers made *identical* domination and "roll-in" claims in both the FERC complaint proceeding (tried in 1980) and the subsequent NCUC proceeding (tried in 1981). Indeed, the customers made these identical claims through the same witness (David Springs) and virtually the same documents in each proceeding. *Compare* FERC Docket No. 78-18, Complaint, *Highlands* v. *Alcoa*, pp. 13–19 (April 24, 1978); *id.*, Tr. 1947-2031, 2217-2362, & App. 279a, 287a-288a, *with* App. 179a-221a & Tr. Vols. 15, 16 & 17. The only material difference between the two proceedings is that the neutral agency, FERC, rejected the North Carolina entities' claims, whereas the self-interested agency, the NCUC, accepted them.

The NCUC's actions are ironic because even it does not contend that it has the power directly to determine the reasonableness of wholesale costs. Yet it has attempted to reach that identical result by reassessing and rejecting the factual premises on which the FERC determination rests. Either way, the NCUC cannot disregard FERC's wholesale cost allocations for the only purpose that really matters: recovery from Nantahala customers.

Scope Of FERC Regulation. Next, the North Carolina parties and *amici* argue that the filed-rate doctrine cannot apply here because, in their view, FERC has not allocated power acquisition costs between the North Carolina public load and the Tennessee manufacturing load. Appellees' Br. pp. 20-21. Instead, appellees claim that FERC regulates and allocates only power supplies.

This argument misperceives what FERC does and ignores what both FERC and the North Carolina Supreme Court have said. Because all electricity is fungible and is intermingled in the vast interstate grid, FERC does not allocate power supplies as such under Sections 205 and 206 of the Federal Power Act; *any* FERC power allocation is necessarily an allocation of costs. In all events, the NFA and 1971 Apportionment Agreement explicitly determine costs; indeed, that is the only purpose of the 1971 Agreement.[12] Thus, when FERC ruled on the Complaint in which Nantahala's customers challenged these agreements, FERC's very first sentence states that the "issue . . . is the appropriate allocation of *costs*" between the North Carolina and Tennessee customers. App. 285a (emphasis added). The North Carolina Supreme Court agrees. It acknowledges that "costs associated with" the FERC-regulated agreements were "actually incurred" by Nantahala, noting that the NCUC reallocated these costs to the "nonjurisdictional Alcoa industrial load" in Tennessee. App. 40a, 69a-70a; see App. 15a, 16a.

[12]Nantahala's power acquisition costs are determined by three agreements: the NFA (which determined the amount of low-cost entitlements to be shared by Nantahala and Tapoco), the 1971 Apportionment Agreement (which established Nantahala's share of those low-cost TVA entitlements), and the 1971 Nantahala contract with TVA (which establishes the rates Nantahala pays for supplemental power purchased from TVA). Because Nantahala's energy and capacity entitlements are *credits* against its TVA purchases, there is no question that the NFA and 1971 Agreement directly determined Nantahala's power acquisition costs—as FERC repeatedly found. App. 281a, 298a, & 309a. See also *Nantahala Power & Light Co.* v. *FERC*, *supra*, 727 F.2d at 1345. Indeed, it is because the NFA and 1971 Apportionment Agreement are wholesale sales and "contracts . . . affect[ing] . . . rates" that they are rate schedules under Section 205 of the Federal Power Act. App. 253a, 263a-66a.

Indeed, even appellees elsewhere admit that FERC's regulation of the agreements determined Nantahala's power acquisition costs, for they acknowledge (p. 16) the "cost[s] arising from the NFA and the 1971 Agreement." Here, they claim that there was no violation of the filed-rate doctrine because, in their view, the costs were not "excluded" in setting Nantahala's retail rates, but "each and every item of cost . . . was recognized and allowed." *Id.* It is not clear how appellees can make such a claim. No one disputes—or can dispute—that the NCUC excluded $2 million of the costs that Nantahala incurred as a result of these agreements from its retail revenue requirements in the 1975 test year, producing a $45 million refund liability. See Appellants' Br. p. 15; App. 234a. Semantics or labels cannot change the fact that this is precisely what the Federal Power Act and the filed-rate doctrine forbid.[13]

Similarly, appellees' repeated assertions (*e.g.*, p. 14) that the issue in this case is whether the Federal Power Act preempts States from "setting . . . retail rates using a roll-in" of the costs of affiliated utilities are simply incorrect. There may well be circumstances in which States may "roll-in" affiliated firms to determine those retail ratemaking costs that are within the state's jurisdiction to determine (*e.g.*, the local utility's administrative costs or costs of capital). See p. 3 n.7, *supra.* But that is not the issue in this case. What a State manifestly cannot do is what North Carolina did here: use a "roll-in" or any other label to defeat FERC's

[13]Appellees' arguments (*e.g.*, pp. 5 & 10) that the NCUC's actions are supported by its finding that Tapoco is a North Carolina public utility are erroneous for the same reason. As FERC found, Tapoco's public utility status under North Carolina law is irrelevant to the cost allocation issue, which is within FERC's exclusive jurisdiction. App. 292a-293a & n.21. Further, the North Carolina finding rests on the fact that the NCUC issued Tapoco a certificate of convenience and necessity at the time that the NCUC, in 1955, purported to *approve* the transfer to Tapoco of two of the hydroelectric plants that are used to serve Alcoa in Tennessee (see App. 272a-73a), so the certificate could not represent a dedication of Tapoco facilities to serve Nantahala's customers even if the NCUC had jurisdiction to so order—which it does not.

regulation of the allocations of wholesale costs between customers in different States. This proposition has been consistently recognized by FERC and state supreme courts alike.[14]

FERC's Cost Allocations. Finally, appellees do not dispute that FERC Opinion No. 139 rejected their factual claims. See p. 6, n.11, *supra.* FERC found that Nantahala's fair share of the low-cost TVA entitlements power was no more than 54.3 mW of capacity and 404 thousand mWh of energy and that there was no basis for shifting any other costs from Nantahala to Tapoco. Yet appellees claim that this FERC Opinion somehow authorized the NCUC to set retail rates on the assumptions (1) that Nantahala receives 92.7 mW of low-cost entitlements capacity (increasing to 100.1 mW and beyond in future years) or almost twice what FERC approved, (2) that Nantahala receives 433 thousand mWh of low-cost energy entitlements (increasing to 460 thousand mWh and beyond), and (3) that Tapoco pays for 75% of the supplemental high-cost TVA power that Nantahala purchases to serve its North Carolina customers. These arguments are astonishing.

Appellees first assert (p. 9) that FERC Opinion No. 139 determined only the rates that Nantahala could charge its three wholesale customers and did not "allocate the cost of power for purposes of retail ratemaking." While this would not support North Carolina's actions even if true (*see* p. 12, *infra*), the assertion is

[14]See Appellants' Br. 33 n.46. In this regard, appellants are baffled by North Carolina's reliance (Appellees' Br. p. 23) on the statement in FERC Opinion No. 139A that "the question of whether to treat various entities as an integrated system for ratemaking purposes is not purely a factual question, but also rests on criteria which each ratemaking authority may deem relevant." App. 305a. Here, FERC was simply rejecting the North Carolina customers' assertion that the fact that the NCUC had adopted a roll-in methodology could mean that FERC was required to do the same. FERC did not even address the question of North Carolina's jurisdiction to make a different interstate wholesale cost allocation than prescribed by FERC's regulation. Moreover, FERC could not relinquish its exclusive jurisdiction over these interstate wholesale cost allocations in any event.

false and contradicted by the North Carolina Attorney General's own undisputed actions.

In Opinion 139, FERC had before it *both* a rate case involving Nantahala's three wholesale customers and a complaint case in which Nantahala's customers charged that its supply arrangements had unfairly inflated Nantahala's costs of obtaining power "for resale" to its entire North Carolina public load, wholesale and retail.[15] Each case required FERC to determine Nantahala's fair share of the low-cost TVA entitlements, and all recognized that the FERC decision in the consolidated proceeding would determine one component of Nantahala's operating expenses for retail as well as wholesale ratemaking purposes. It was for this reason that the North Carolina Attorney General intervened in the proceedings on behalf of Nantahala's retail customers and unsuccessfully claimed that FERC should order the very cost reallocations that the NCUC subsequently adopted. Indeed, the North Carolina Attorney General appealed FERC's decision in FERC Opinion No. 139 *solely* on the ground that it was error not to grant greater relief in the complaint case. *Edmisten* v. *FERC*, No. 82-1948 (4th Cir.); see 727 F.2d 1342. For these reasons, appellees' claim that FERC's decision was limited to the three wholesale customers is spurious.

Appellees' remaining arguments all proceed from the fact that FERC did not find that the NFA and 1971 Apportionment Agreement were fair to Nantahala's customers in each and every respect, but required one adjustment to assure Nantahala's customers their fair share of the energy entitlements: that Nantahala

[15]Complaint, *Town of Highlands* v. *Alcoa*, FERC Docket No. EL 78-18, pp. 13-19. In addition, when FERC earlier accepted the 1971 Apportionment Agreement for filing under Section 205 of the Federal Power Act, FERC stated that the "reasonableness of the apportionment arrangement shall be subject to the outcome" of the wholesale rate case and the complaint proceeding. App. 266a. FERC's cost allocation determinations in Opinion 139 thus governed a third proceeding as well.

be treated as receiving 404 thousand mWh, rather than 360 thousand mWh. This adjustment simply establishes a new "filed rate" that also binds the NCUC. Yet appellees claim that the fact that FERC made one adjustment to the provisions of the contracts as originally filed means that the NCUC can radically depart from the arrangements that FERC expressly approved and thereafter ignore FERC jurisdiction altogether. This is a *non sequitur*.

The claim depends entirely on the North Carolina entities' assertions (Appellees' Br. 10, Highlands' Br. p. 9-10) that FERC did not modify Nantahala FERC Rate Schedule No. 1 in Opinion 139. But these assertions are false and could not support North Carolina's position even if they were true.

The entire basis for the argument that the pertinent rate schedule was not modified is that FERC did not reform the underlying contracts; instead, it protected the customers' interests by prescribing that Nantahala would be regulated "as if" it had received the additional 44 thousand mWh of energy required to give it its "fair percentage." See Appellees' Br. p. 29. However, the fact that an underlying contract is not reformed cannot establish that the rate schedule was not modified.[16] Thus, the only

[16]This Court has long recognized that FERC's authority to regulate "the service in which the producer engages is distinct from the contract[s]" that govern the utility's relationships with others and that FERC has the authority to regulate such service on a different basis than contained in any underlying private contract, without reforming it. *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 152-53 (1960); *see Pennsylvania Water & Power Co.* v. *FPC*, 343 U.S. 414, 422 (1952). Here, moreover, FERC stated that it rejected the Staff proposal to reform the contract *only* because it was not necessary "to remedy this situation" in that (1) the alternative under which Nantahala is regulated "as if" it received an additional 44 thousand mWh of energy entitlements would fully protect ratepayer interests (by reducing Nantahala's reasonable power acquisition costs and rates accordingly) and (2) there did not appear to be any reason or basis for reforming contractual arrangements between Nantahala and TVA or Tapoco directly. App. 280a-281a, 305a, 308a-309a. Thus, the failure to reform the agreement has no significance.

possible basis for appellees' argument is that Opinion 139 did not expressly state that Nantahala would be treated as having received the additional energy for all purposes, retail as well as wholesale. But this is the necessary meaning of the FERC order if, as appellees assert, FERC found that the 1971 Agreement's energy allocation is unfair. Section 206 of the Federal Power Act provides that where, as here, FERC finds that a practice or contract affecting rates is "unjust," FERC "shall determine the just and reasonable . . . practice. . . . to be *thereafter observed and in force*." App. 257a. (emphasis added) Indeed, as appellees recognize (Br. p. 19), FERC could not have validly entered the order it did with respect to Nantahala's three wholesale customers (and the Fourth Circuit could not have affirmed it) unless Nantahala FERC Wholesale Rate Schedule No. 1 had been so modified. Significantly, FERC itself has construed Opinion 139 to modify FERC Nantahala Rate Schedule No. 1,[17] and the appellees' contrary argument is nothing more than an assertion that FERC does not understand its own order.

Further, even if FERC had not modified the rate schedule, this omission could not help appellees. The only alternative interpretation of the FERC decision is that no change was made to the rate schedule as originally filed. In that event, the filed-rate doctrine would require North Carolina to give effect to the contracts as written, and Nantahala's retail rates would have to be set on the basis that it receives the 54.3 mW of low-cost capacity entitlements and the 360 (rather than 404) thousand mWh of energy entitlements provided by the 1971 Apportionment Agreement. That would require increases in Nantahala's authorized retail rates beyond even those that appellants advocate.

In all events, this Court need not attempt to resolve any ambiguities in FERC Opinion No. 139 to decide this case. In 1981, the NCUC's obligation under the Federal Power Act and the

[17]Brief for the United States and The Federal Energy Regulatory Commission As Amici Curiae Supporting Appellants (January, 1986) ("FERC Amicus Br."), p. 5.

Commerce Clause was to include all the costs incurred as a result of Nantahala FERC Rate Schedule No. 1 in Nantahala's retail revenue requirements and rates (subject, in NCUC's discretion, to a future refund only to the extent that the rate schedule was modified in the then-pending FERC proceedings). Thus, this Court can and should reverse on the ground that the NCUC violated this federal requirement. If the NCUC or other affected parties really believe that FERC Opinion No. 139 suffers from a lack of clarity on this issue or any other, North Carolina can, on remand, file an appropriate application for clarification with FERC under Section 306 of the Federal Power Act. This is their exclusive remedy.

B. There Is No Basis For Creating The Urged "Exception" To The Filed-Rate Doctrine.

Appellees also argue (p. 24) that there should be an "exception" to the principle that FERC has exclusive jurisdiction over interstate wholesale cost allocation issues. That exception would permit States to determine whether "FERC-allocated costs" should be "borne by the retail utilities ratepayers or its shareholders" and to refuse to give effect to FERC rate schedules (and the underlying wholesale cost allocations) in setting retail rates.

This is simply a claim that States should be allowed to interfere with "FERC's authority to regulate the proper determination of the allocation of costs" (*contra, Maryland* v. *Lousiana*, 451 U.S. 725, 749-50 (1981)) and to recreate the same state of affairs that the Federal Power Act—and the Commerce Clause itself—were adopted to prevent. The facts of this case vividly demonstrate the point. It is undisputed that the NCUC here adopted an interstate cost allocation methodology which would, if also adopted by Tennessee, permit recovery of only 70% of the wholesale production and distribution costs through wholesale and retail rates. Appellants' Br. 30; Tr. Vol. 15, p. 119. It is the risks of such short-

falls and the resulting economic strife among States that it was the purpose of the Federal Power Act and the Commerce Clause to end. See Appellant's Br. 29-32.

Nor is there a "developing" line of state cases that adopts this view. Compare Appellees Br. p. 24. To the contrary, it has been the *state* supreme courts that have developed the body of case law that prevents the kind of economic balkanization that North Carolina advocates.[18] These States uniformly recognize that it is in the interest of all if FERC alone referees wholesale cost allocation disputes among them. There is only one exception. It is North Carolina.

In this respect, appellees' (pp. 24-26) and amicus Highlands' (pp. 18-20) reliance on *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985), and *Pike County Light & Power Co.* v. *Pennsylvania Public Utilities Commission*, 77 Pa. Commonw. Ct. 268, 465 A.2d 735 (1983), is misplaced. Those courts held only that there are circumstances in which States can exclude from retail rates power acquisition costs incurred under one FERC rate schedule on the ground that the retail utility could have obtained its power at a lower cost from a different wholesale supplier under a *different* FERC rate schedule. Neither decision permits a State to make its own determination of how interstate

[18]Appellees' reliance (p. 25) on *Public Service Co.* v. *Public Utils. Commn. of Colorado*, 644 P.2d 933 (Colo. 1982), and *Washington Gas Light Co.* v. *Public Service Commn. of District of Columbia*, 452 A.2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983), is misplaced. In each, the state supreme court held that the state commission was required to do precisely what the NCUC refused to do here: include all costs incurred under the pertinent FERC rate schedule in retail revenue requirements. The fact that each court held (as did the court in *Narragansett*) that increases in FERC rates need not automatically be passed through to retail ratepayers merely reflects that federal law fixes only one component of retail revenue requirements—the reasonable power acquisition expenses—and that a State can permissibly find savings in other aspects of the utility's business that offset increased purchased power expenses. See Appellants' Br. pp. 26 n.36, 28 n.40.

wholesale costs should be allocated between different States.[19] In any event, while there is some question whether either decision withstands analysis,[20] this Court need not address that issue. *Sinclair* and *Pike County* have no applicability here and cannot justify what North Carolina has done.

These decisions recognize that those costs that flow from particular wholesale transactions must be included in retail revenue requirements if FERC has "expressly or impliedly" determined the power supply arrangements that are fair to a utility's ratepayers. *Sinclair*, 498 A.2d at 704. Here, FERC investigated and rejected claims that Nantahala and its retail customers should have obtained more than 54.3 mW of capacity and 404 thousand mWh of energy from the pool of low-cost hydroelectric power that resulted from Tapoco's and Nantahala's facilities. Indeed, the issue whether this arrangement was fair and reasonable to Nantahala's retail customers was at the heart of the FERC complaint proceeding. See p. 6 n.11. Thus, *Sinclair* and *Pike* each

[19]Under *Sinclair* and *Pike County*, the interstate cost allocations that underlie *each* FERC wholesale rate schedule remain the exclusive province of FERC. *Pike* and *Sinclair* merely allow States to set retail rates in some circumstances as if the local utility had acquired its power under one FERC schedule rather than another.

[20]The issue posed by the *Pike County* and *Sinclair* holdings is whether the Federal Power Act preempts states from deciding issues which FERC *could have* decided (because they came within its jurisdiction) but did not. The amicus briefs filed by the Edison Electric Institute and the New England Electric System (p. 15 n. 9) argue that the *Sinclair* and *Pike County* holdings on this issue are inconsistent with the Federal Power Act and with general preemption principles. *Cf.* Appellants' Br. p. 28-29 n.41. Whatever the merits of those arguments, they need not be reached in this case. Here, the issue is not one that FERC merely could have decided if it had elected to do so. Rather, the only issue is which allocation of the NFA entitlements is fair to Nantahala's customers, and FERC decided that issue. *Sinclair* and *Pike* squarely recognize that there is preemption where FERC has faced the issue and made a decision, for they hold that the authority of state regulators reaches only "those matters not resolved by the FERC." *Sinclair*, 498 A.2d at 704; see *Pike*, 465 A.2d at 737-38.

prohibit North Carolina from adopting a different interstate cost allocation in setting retail rates.

II. North Carolina's Actions Violate The Commerce Clause.

Finally, the North Carolina entities have also offered no substantial response to appellants' argument that the Comm rce Clause would, by its own force, prohibit North Carolina's actions even if the Federal Power Act did not preempt them. The North Carolina entities do not dispute that the Federal Power Act provides the "same substantive protections" with respect to the interstate wholesale cost allocations at issue as does North Carolina law and that there is no local interest that could justify North Carolina's actions if they substantially interfere with Commerce Clause values. *Edgar* v. *MITE Corp.*, 457 U.S. 624, 644-45 (1982). Thus, the North Carolina entities defend the NCUC order solely by contending that it does not affect interstate commerce in any material way. They assert that all the NCUC has done is regulate retail transactions within North Carolina and that, in any event, any extraterritorial regulation is "evenhanded" and has, at most, a *de minimis* effect on interstate commerce. Appellees' Br. pp. 28-35.

However, the attempt to disavow the interstate character of the NCUC's action is squarely refuted by the terms of the NCUC's order. As the North Carolina Supreme Court stated, the NCUC set retail rates by reallocating power acquisition costs between two States and "effectively allocated" $45 million in costs "to the industrial load customer (Alcoa) in Tennessee," ordering Alcoa to "refund" these amounts to the North Carolina retail customers.[21]

[21]North Carolina's actions will constitute impermissible extraterritorial regulation and blatant economic protectionism, regardless of how the refund order is characterized. However, the North Carolina Supreme Court statements, and the entire history of the case, refute the repeated assertions (*e.g.*, Appellees' Br. pp. 3, 32) that the $45 million refund obligation was imposed on Alcoa as the shareholder of Nantahala, not as

(Footnote continued on following page)

App. 16a, 69a-70a. Indeed, because the NCUC's methodology requires that it "extend its control into the interstate area" by treating a "local utility and a distinct out-of-state entity as a single unit for cost and ratemaking purposes" (FERC Amicus Br. p. 19 n.13), any claim that interstate commerce is unaffected is self-refuting. As FERC states:

> "The state is inconsistently attempting both to create an interstate entity for purposes of establishing costs, and denying its interstate character for purposes of asserting its ratemaking authority. But North Carolina's attempt is equivalent to creating an inter-utility bulk power transaction, to obtain Tapoco's power for Nantahala and its North Carolina customers. This the state utility commission is forbidden to do, both by the Federal Power Act and this Court's pre-Act Commerce Clause cases." FERC Amicus Br. p. 19 n.13.

The claims (pp. 30-32) that North Carolina has acted "evenhandedly" and applied a "traditional cost allocation methodology" stand in even starker contrast with its actions. Appellees can make this argument only by ignoring that North Carolina has not only allocated to itself radically greater amounts of the pool of low-cost power than FERC had determined to be North Carolina's fair share, but also has allocated itself *ever-increasing* amounts. Appellees do not dispute, and cannot dispute, that their own witness testified that this methodology would give the North Carolina public load the benefits of all the low-cost North Carolina and Tennessee hydroelectric power by 1989, with none for the "Tennessee (Alcoa) manufacturing load." Appellants' Br. p. 36; Tr. Vol. 17, pp. 38-39. Appellees do not dispute, moreover, that North Carolina's share will continue to increase whenever its

(Footnote continued from previous page)

the Tennessee customer. The *sole* predicate for North Carolina's actions was its finding that the economic benefits of North Carolina resources had been unfairly transferred to Alcoa's Tennessee smelting facility and that the $45 million in costs were "actually incurred" to benefit "the systems' industrial customer, Alcoa" in Tennessee. App. 69a-70a; see *id.* 15a, 16a, 40a.

needs do, whether or not Tennessee's needs increase at the same (or a faster) rate. See Appellants' Br. 11-14. Nor do appellees dispute that this is precisely the kind of protectionism that the Commerce Clause is designed to prevent.

Indeed, Appellants' Brief demonstrated at length (pp. 11-14) that these economic preferences resulted from three separate but interrelated aspects of the NCUC's methodology, each of which is flatly inconsistent with FERC's explicit findings. Yet Appellees' Brief makes no attempt to explain or defend any of the three. Bald assertions of "evenhandedness" cannot alter the preferential character of the NCUC's interstate allocation. The Commerce Clause thus prohibits North Carolina from setting retail electric rates on the basis of a different allocation of the low-cost TVA entitlements than FERC approved.

CONCLUSION

For the reasons stated in this brief and appellants' opening brief, the decision and judgment of the North Carolina Supreme Court should be reversed.

Respectfully submitted,

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